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DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

The Economic Situation In South Vietnam

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March 1971

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
March 1971

INTELLIGENCE MEMORANDUM

The Economic Situation In South Vietnam

Highlights

The new reform measures enacted on 5 March had relatively little immediate effect on retail prices, which by 8 March were only 2% above the level of last July.

New stabilization measures were enacted to slow the growth of the money supply, which increased 16% during December and January. Most significant was the decision to sell substantial amounts of treasury bills to the public and the commercial banks in order to reduce government borrowing from the National Bank. The government also acted to stimulate the domestic rice market by raising the price of imported rice to equal that of domestic rice. Government employees were granted a compensatory increase in their cost-of-living allowances.

For political purposes and despite the objections of his economic advisers, President Thieu has decided to exempt government employees from the income tax and ordered a halt to a probe of major tax evaders.

Layoffs of Vietnamese workers employed by the United States have caused little concern, but unemployment could become a problem in cities such as Da Nang and Nha Trang as reductions in force continue.

Charts on foreign exchange reserves, money supply and prices, import licensing, currency and gold prices, and the government budget follow the text.

Note: This memorandum was prepared by the Office of Economic Research.

Prices

1. Saigon prices continue to be remarkably stable, and economic measures enacted by the government on 5 March (see paragraphs 5-12) so far have had relatively little effect. During the week ending 8 March, prices of some items affected by the reforms, such as bread, brown sugar, and condensed milk, increased from 10% to 50%, but the overall index rose less than 2%. As of 8 March the price level was no higher than in December 1970 and only 2% above that of last July.

2. During the first six weeks of 1971 the USAID price index for imported commodities rose 3%, but as of 16 February the index still was no higher than in October 1970. More recent data are not available.

Money Supply

3. Following a 4% increase in December, the money supply rose 11% in January, primarily because of GVN deficit financing. Advance deposits for imports declined about 1 billion piasters during January, but savings and term deposits increased almost 4 billion piasters, an increase of 11%.

Currency and Gold

4. Saigon black market currency prices have remained relatively stable since last October. On 8 March the price of dollars was 398 piasters per dollar, and the rate for MPC (scrip) was 270 piasters per dollar. The price of gold leaf has edged up in recent weeks, reaching 502 piasters per dollar on 8 March, compared with an average price of 488 in January. Most of the increase probably is due to the higher price of gold in Vientiane which in turn reflects higher prices in London.

Additional Economic Reforms

5. As a follow-up to the economic reforms of last October, the GVN enacted a series of additional measures on 5 March. The major purposes

of the measures are to stimulate the marketing of domestic rice and to stem the increase in the money supply and, thus, it is hoped the increase in prices. According to US estimates, the net effect of the reforms should slow the projected increase in the money supply by roughly half, or down to less than 15% in 1971.

6. In a long-awaited move, the government raised the official wholesale price of imported rice to the level of equivalent domestic varieties. The increase amounted to 38% for medium-grain rice (from 30 to 41.5 piasters per kilogram) and 31% for long-grain rice (from 34 to 44.5 piasters per kilogram). By eliminating the price advantage imports have had over domestic rice, the government hopes to encourage the marketing of the now adequate supplies of Delta rice throughout the country, especially in the northern rice-deficit provinces, and thus end dependence on imports. A preliminary step in this direction was taken last October when prices of imported rice in Military Regions 1 and 2 were increased to equal the price of imported rice in Saigon.

7. The price increase will fall mainly on government employees who apparently have satisfied nearly all their rice requirements through purchases of imported rice at the official low price. Prices of the small amount of imported rice sold on the free market in Saigon have been generally in line with domestic rice prices. To compensate civil servants, the armed forces, veterans, and pensioners, the government will increase their cost-of-living allowance by 100 piasters per month for each family member. For many families, however, this allowance may not cover the increase in rice prices. If, as has been estimated, the average monthly consumption of rice is 12 kilograms per person, the increase in the cost of medium-grain rice would amount to 138 piasters per family member.

8. The most important of the new stabilization measures enacted by the government is the market sale of treasury bills, which will enable the government to reduce its borrowing from the National Bank, which generally must resort to

printing more piasters. Sales will be open to the public, but most bills will be sold to commercial banks. The treasury bills will carry annual interest rates ranging from 12% for a three-month maturity to 22% for a 24-month maturity and will be tax exempt. Considering the current low rate of inflation, such interest rates should be attractive, and the government hopes the move will encourage commercial banks to seek more savings deposits. Sales of treasury bills are expected to amount to about 15 billion piasters during the remainder of 1971, or more than one-third of government borrowings from the National Bank in 1970. As a further inducement to savings, commercial banks will be permitted to issue anonymous certificates of deposit.

9. The sale of treasury bills will be an especially significant factor in reducing the increase in the money supply because absorption of money by imports has been less than expected. Import licensing under the Commercial Import Program has averaged about $20 million per month since October instead of the estimated $30 million. Orders for GVN-financed imports have averaged about $30 million per month, or $5 million less than anticipated. As a result of lower licensing and some reductions in rates, the absorptive effect of advance deposits for imports, which were part of the reforms last fall, has peaked somewhat earlier and at a lower level than expected. These deposits were expected to reach a maximum of about 25 billion piasters in January, but instead reached a high of about 14 billion piasters in December and declined in January.

10. The remaining new stabilization measures focused on increasing taxes and shifting additional import transactions to the parallel market exchange rate established last October. Freight and insurance charges on GVN-financed imports and US-financed imports of surplus agricultural commodities (PL-480, Title I) will now be calculated at the rate of 275 piasters rather than 118 piasters per dollar. Imports under the US-financed Commercial Import Program are not affected. POL imports also were exempted from the higher freight and insurance charges because higher prices had

just been announced for POL products in late February as a result of the increase in world market prices.

11. Higher perequation taxes -- a customs duty that can be increased by executive decree -- were announced for imports of sugar and wheat flour. The new rates are expected to produce additional revenues of about 10 billion piasters annually, which is equivalent to about half of total perequation tax revenues collected in 1970. In the case of sugar, the higher tax on imports also is designed to stimulate domestic sugar cane production, which declined 71% during 1966-69.

12. According to early reports, public reaction to the government's action has been relatively mild. Saigon retail prices of some items affected by the measures jumped sharply by 8 March, but the overall price level increased less than 2%. From the standpoint of both political and economic considerations, the timing of the reforms probably was good. The relative price stability that has prevailed since last summer has helped calm the political situation, and any repercussions from the new economic moves probably could be better absorbed now than when the political climate heats up prior to the elections. With money supply increasing fairly rapidly recently and expected to increase even more rapidly later on this year, restraining measures probably were necessary to prevent inflation from gaining momentum again. The reforms almost certainly will be the last significant action in the economic field until after the elections, when a complete revision and simplification of the tariff schedule for imports probably will be submitted for legislative approval.

Politics and Taxes

13. A week prior to the enactment of the reforms, President Thieu proposed that the civil service and the armed forces should be exempt from paying income tax for the duration of the war. He also ordered a halt to the tax census which began with much fanfare in the major towns and cities in December. Both moves -- designed to gain support for Thieu's reelection -- are opposed by Vietnamese and US economic officials.

The tax exemption, which must be approved by the National Assembly, would cause a minimal reduction in government revenues because only higher salaried employees earn enough to pay any income tax. The estimated loss in revenues would amount to less than 0.1% of total government revenues in 1970. The tax exemption, however, could damage the GVN's image in the United States. The tax census was aimed primarily at uncovering evasion among the professional and business communities, and its curtailment could stifle initiative among government tax authorities to increase their collection efforts. Minister of Economy Ngoc has told US officials, however, that the survey is complete except for a few areas in Saigon and that the presidential order does not preclude exploiting the information that has been gathered.

US Sector Employment

14. The steady decline since mid-1969 in the number of Vietnamese employed by US military and civilian agencies and their contractors apparently has caused no major difficulties, but unemployment could become a problem in some areas of the country as layoffs continue. From an all-time high of 160,000 in June 1969, US sector employment fell to 126,000 at the end of 1970. During 1970, 22,000 Vietnamese were laid off and an additional 34,000 are to be let go this year as US troop reductions continue. The actual number of Vietnamese workers affected by the US withdrawal, however, certainly is much greater. In addition to the reported employment, there are thousands more who are employed privately by US civilian and military personnel or whose jobs depend on the spending of the Vietnamese who work for Americans.

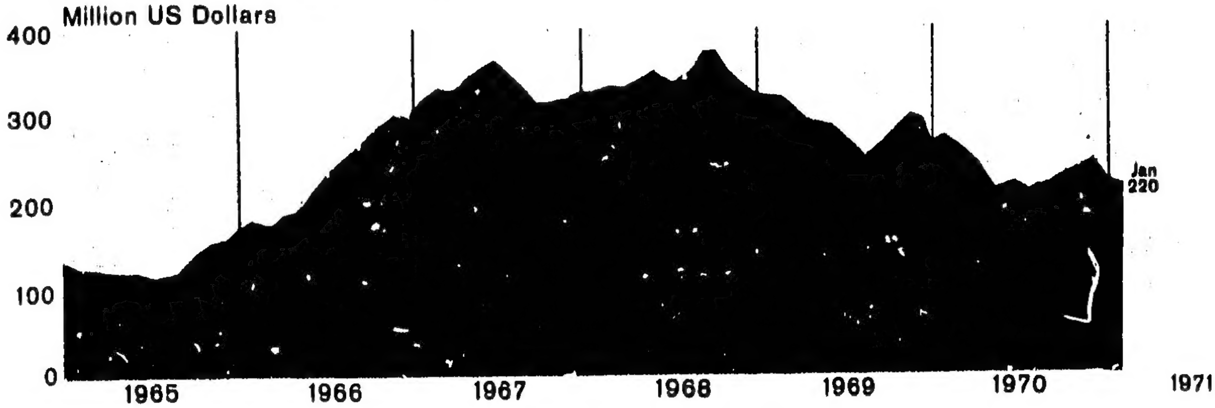
15. So far, those laid off apparently have been able to find new jobs easily in the generally tight labor market. The armed forces still are taking in more than 20,000 young men a month. In addition, the fact that about two-thirds of the Vietnamese working for the United States have some manual or technical skill undoubtedly has eased the transition. As reductions in force continue, however, there may be some cause for concern especially in cities in Military Regions 1 and 2. In

Da Nang, for example, US officials estimate that 40%-50% of the city's wage earners either work directly for Americans or for Vietnamese firms servicing US activities. Similar situations probably exist in Qui Nhon, Nha Trang, and Cam Ranh. A USAID team toured Military Region 1 in mid-January and reported no visible signs of substantial unemployment and no mention by local officials that unemployment was a major problem. But no one is sure that it will not be a problem in the near future. Scheduled layoffs during 1971 by military agencies and contractors, who employ 95% of the Vietnamese working in the US sector, are as follows:

Military Region 1	7,300
Military Region 2	11,200
Military Region 3	12,900
Military Region 4	3,000
Total	*34,400*

16. US officials are considering ways to assist the Vietnamese government in areas where substantial unemployment may occur -- mainly through public works projects on roads, bridges, canals, and the like. It apparently is difficult, however, to arouse much concern over the issue. The prevailing attitude seems to be that since there have been few problems as a result of US dismissals in the past, there will be few in the future.

SOUTH VIETNAM
Foreign Exchange Reserves*



*Excluding holdings of commercial banks

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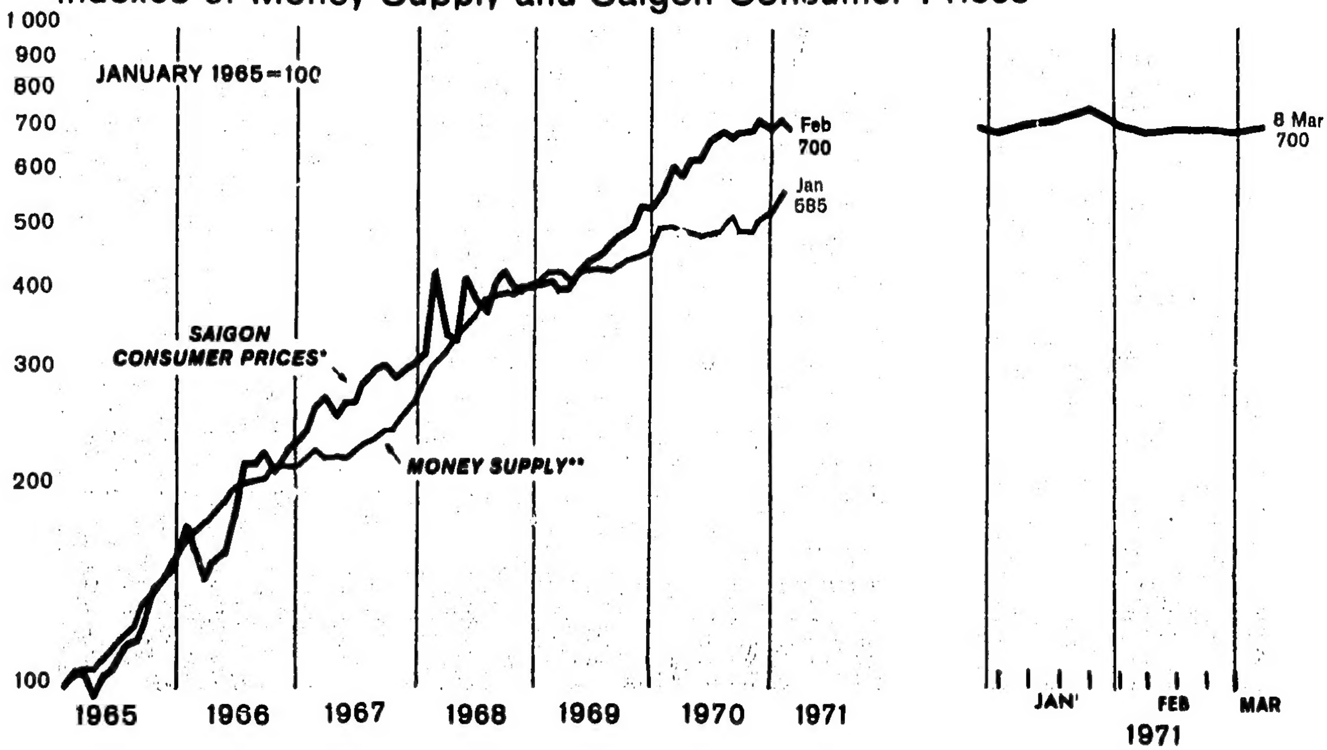
SOUTH VIETNAM
Indexes of Money Supply and Saigon Consumer Prices



*USAID monthly average retail price index for Saigon
**Data are for end of month

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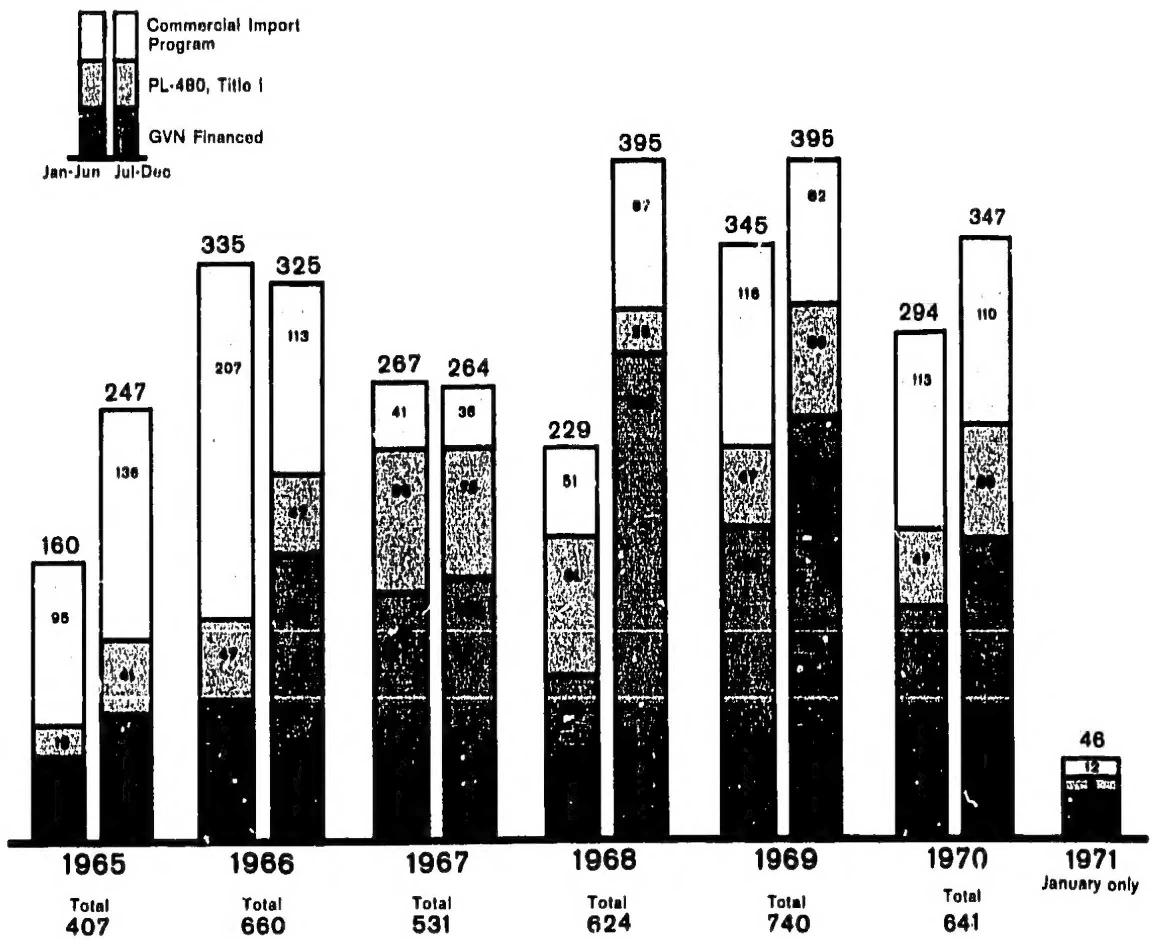
IMPORT LICENSING
Million US Dollars



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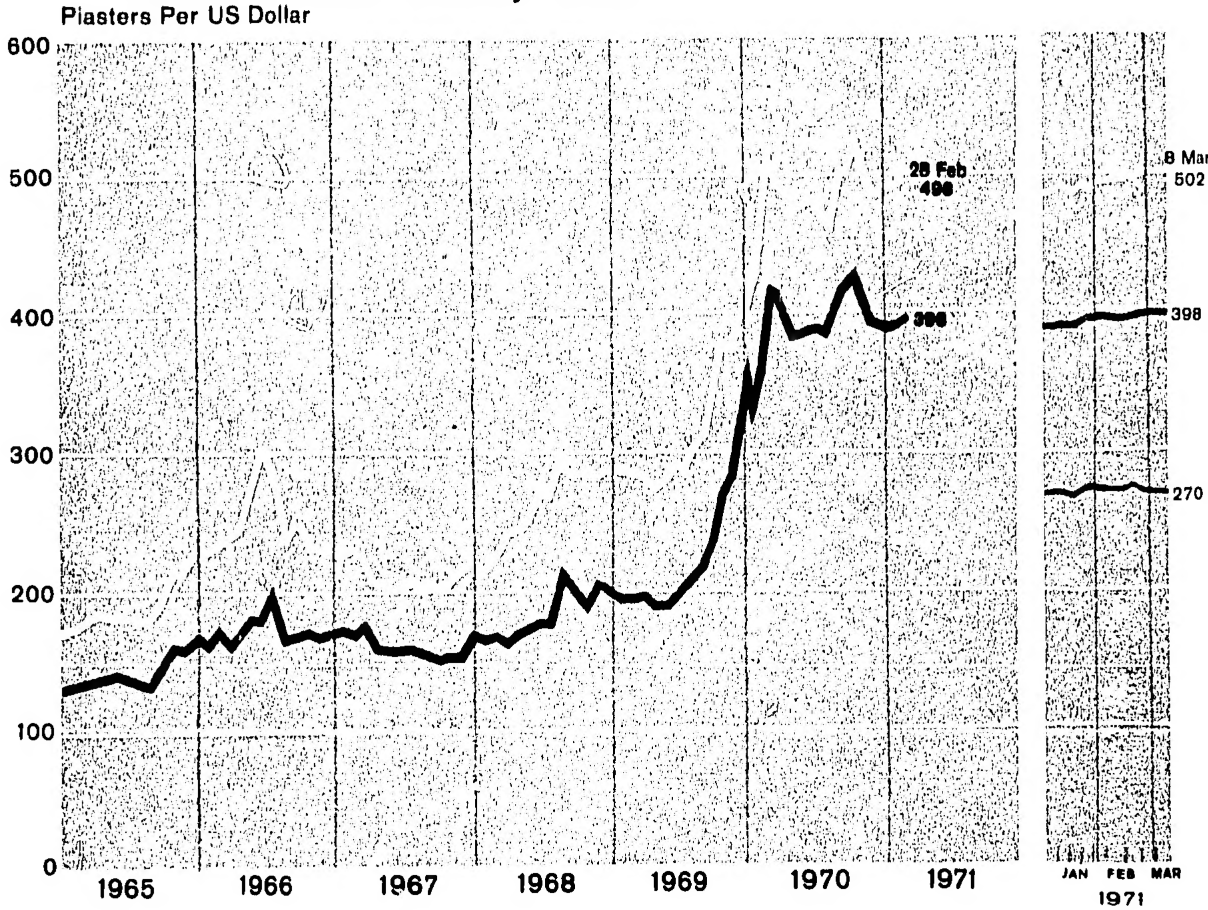
SAIGON

Free Market Gold and Currency Prices

Piasters Per US Dollar



GOLD Basis: gold leaf worth
$35 per troy ounce

US $10 GREEN

US $10 MPC Military Payment
Certificates (scrip)

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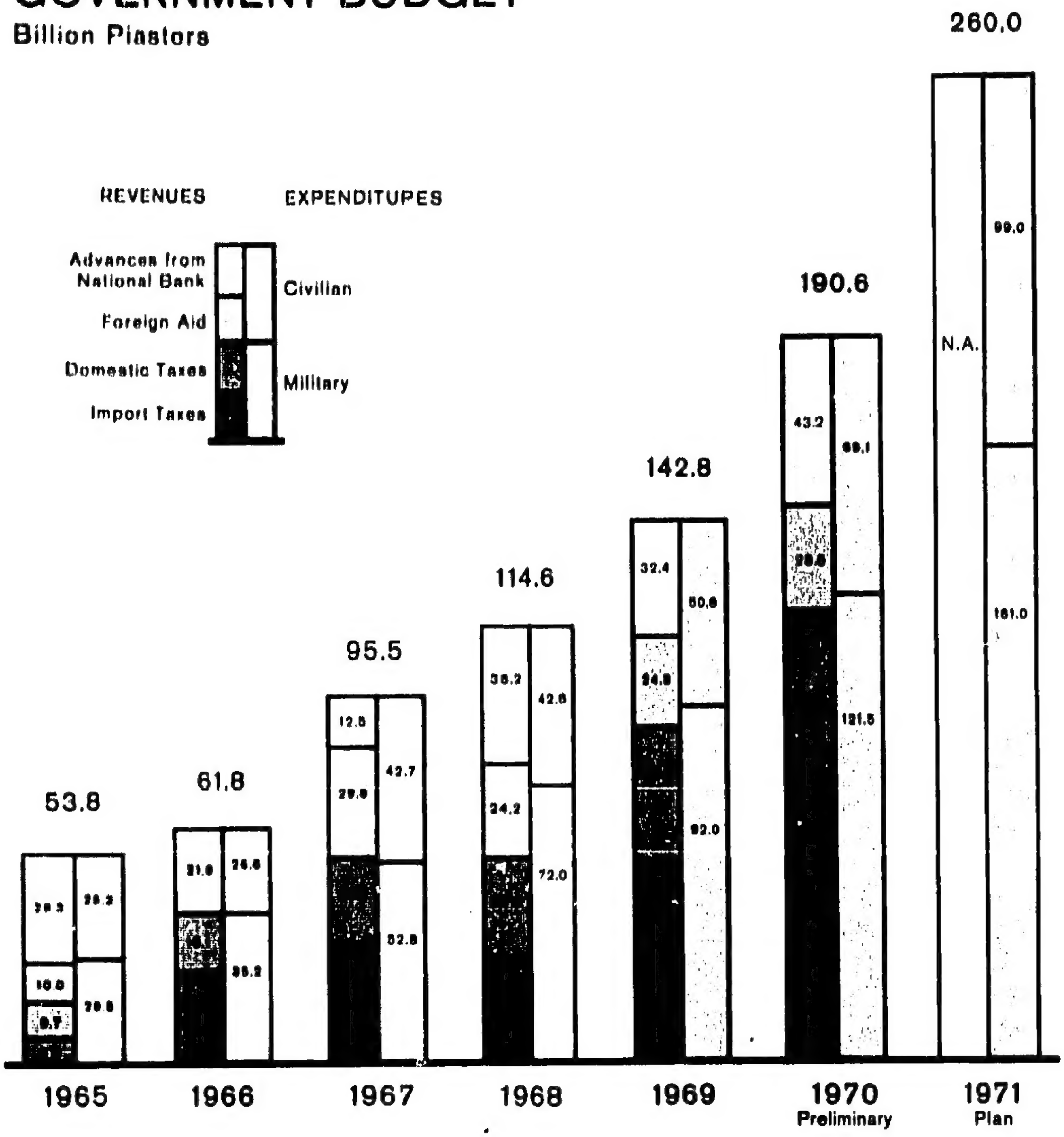
GOVERNMENT BUDGET*

Billion Piasters



*Data include extrabudgetary revenues and expenditures